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SUBJECT: KENYA'S PRESIDENT GOES TO CHINA - AND WHAT IT MEANS

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¶1. (SBU) Summary: Kenyan President Mwai Kibaki's August state visit to China was clearly aimed at further developing a bilateral economic relationship which, while small, is growing rapidly. Trade and tourism are especially robust. Investment by Chinese firms in Kenya has yielded less-spectacular results, partly because it doesn't make much economic sense for Chinese manufacturers to produce in Kenya what they can more cheaply export from home. In part as a result, bilateral trade relations are heavily skewed in China's favor, and there is a great deal of fear and concern in Kenya about China's competitiveness, especially in Kenya's once-fledgling garment sector. While much of the bilateral China-Kenya economic relationship is private sector-driven, the Chinese government also greases the skids by providing grants and concessional loans tied to the use of Chinese firms, often for the completion of large infrastructure projects in roads, power, and telecommunications. Kenya does not offer a significant source of natural resources to China, but a Chinese firm is reportedly heavily involved in a new project to mine titanium in Kenya -- and China is interested in seeing South Sudan oil piped to the Kenyan coast. While some may see the Kibaki visit as part of an effort to curry favor with Beijing at the West's expense, we see it in more prosaic terms: a poor country in Africa recognizing the need to build ties to a rising economic powerhouse in Asia. End summary.

¶2. (U) Kenyan President Mwai Kibaki made a state visit to China (Shanghai, Shenzhen, and Beijing) August 16-21 in what one local columnist dubbed "probably the most important foreign visit of the Kibaki presidency...More important, even, than the 2003 visit to the United States." Joining Kibaki were six ministers (Foreign Affairs, Finance, Information and Communication, Tourism, Land, and Local Government) and a delegation of lesser officials and state-owned enterprise executives. Deliverables from the visit, which Post will continue in the weeks ahead to try to learn more about and confirm, include the following:

-- Bilateral framework agreement under which the Chinese government will provide KSh 600 million ($8 million) in grants to supplement an earlier grant of $6.7 million for road rehabilitation in Nairobi. The agreement also provides for a concessional loan of KSh 2 billion ($26 million) for improvements in Kenya's electricity distribution system.

-- Bilateral air services agreement that will grant Kenya Airways landing rights in Guangzhou beginning in October, and thereafter to other Chinese cities.

-- Bilateral agreement on cooperation in radio broadcasting between the Ministry of Information and Tourism and China's State Administration of Radio, Film and Television.

-- The official launch of the Kenya Tourism Board's MagicalKenya website for the Chinese market.

Trade: Growing Quickly From a Low Base

¶3. (U) The Kibaki visit to China appears clearly aimed at giving added impetus to an economic relationship that has been growing rapidly in the past two years, albeit from a low base. Looking first at trade, media reports and the PRC's Nairobi-based Econ/Commercial Counselor cite a 40% growth in bilateral trade - perhaps based on Chinese statistics. However, GOK statistics show that total bilateral Kenya-Mainland China trade was up just over 60% in 2004 to KSh 13.7 billion ($183 million), after growing by nearly a third in 2003. Either way, this trade is skewed overwhelmingly in China's favor: According to Kenyan figures, Kenya exported only $12 million to the PRC in 2004 against imports of $170.5 million. For Kenya, however, this trade still amounts to only a small proportion of its total trade with the rest of the world: 2.4% in 2004, but this is up from 1.8% in 2004 and 1.5% in 2003. By comparison, total trade with the EU accounted for nearly a quarter of Kenya's

worldwide total in 2004; trade with fellow COMESA countries accounted for 15.4%. The U.S. accounted for around 4% of Kenya's total trade in 2004, down from 5.1% and 5.7% in 2003 and 2002 respectively.

¶4. (U) Hard data on the composition of trade is hard to come by, but according to China's Econ/Commercial Counselor, most Chinese exports are "light industrial" consumer goods. A dated Chinese government website lists household appliances, industrial and agricultural tools, textiles, building materials, and drugs as the primary Chinese exports to Kenya. Kenya in turn exports tea, coffee and leather goods to China.

¶5. (U) For Kenya, an emerging services export to China is tourism. In fact, one of the immediate aims of the Kibaki visit was to promote Chinese tourism in Kenya, both as a means to boost tourist export revenues, and to diversify Kenya's tourist industry away from dependence on Europe (the UK, Germany, and Italy provided over 40% of Kenya's arrivals in 2004) and the United States. The Chinese government's decision last year to include Kenya on its list of approved tourist destinations led in part to the nearly 85% increase in arrivals from China in 2004. By comparison, arrivals from the UK were up 36% and from the U.S., 41%. That said, China still ranks only 18th on the list of top tourist origin countries for Kenya, accounting for just 1.5% of all visitors to Kenya in 2004. In comparison, the UK, at nearly 20%, was first; the U.S. was third with 9.4% - by far the best showing among non-European countries. Chinese tourism in Kenya is widely expected to continue to expand at a rapid pace in 2005 and beyond, thanks to better air connections in the wake of the air services agreement, better tourism marketing by Kenya in the Far East, and greater prosperity in China generally.

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Foreign Direct Investment: Chinese Find It Easier to Trade
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¶6. (SBU) Kibaki's visit was aimed as much at luring Chinese businesses to Kenya as promoting Kenyan exports to the Middle Kingdom. Without offering details, China's Econ/Commercial Counselor believes total Chinese foreign direct investment (FDI) in Kenya exceeds $100 million. This is higher than, but on the same order of magnitude as the $72 million in Chinese FDI officially registered at the Kenya Investment Promotion Center. The latter is spread across 109 Chinese companies which have since 1990 provided 9,500 jobs. These enterprises represent a fairly broad cross-section of sectors, including the importation and processing of food products, the export of coffee, travel and tourism, restaurants and other wholesale and retail food establishments, engineering, telecommunications, and, obviously, general importing and distribution.

¶7. (U) Definitive up-to-date data on total FDI in Kenya are hard to come by, but it is likely that total Chinese FDI accounts for only a small fraction of Kenya's total stock of FDI, and recent FDI flows from the PRC have not been growing at nearly the same pace as trade. Of total Chinese FDI registered by the Kenya Investment Promotion Center, more than half ($37.4 million) was invested in the five-year period between 1995 and 1999. The longer period from 2000 up to the present has seen less -- an additional $30 million -- and flows in 2004 were actually more than a third lower than in 2003. Chinese FDI in 2005 is likely to be lower still based on the current trend.

¶8. (SBU) Most observers chalk up the relatively slow pace of Chinese investment in Kenya to the fact that much of the investment is in small businesses which are not capital intensive, including in particular import and distribution firms. It apparently doesn't pay for Chinese firms to invest in large, capital and/or labor intensive manufacturing businesses in Kenya, given the economy's high costs and the relatively small size of the market. Rather, it is far easier and more cost effective in most sectors for China to simply export consumer and heavy manufactured goods. That said, a Chinese firm, AUCMA, recently established a TV and home appliance assembly plant near Nairobi, and in June 2005, Chinese firm North China Grid announced its intention to invest in a $3 million venture in Kenya that will manufacture concrete poles for power lines. It was reported by the media as "the biggest single investment by a Chinese company in Kenya."

Grants and Assistance: Strings Attached

¶9. (SBU) It is apparent that while much of the expansion in the Kenya-PRC economic relationship is nominally driven by private sector actors, this drive is in turn pushed along by the kind of assistance and concessional financing flows that formed the centerpiece of the August 16-21 state visit to the PRC. While hard and fast numbers are difficult to come by, Kenya's total current debt stock to Chinese sources was

around $30 million at the end of 2004, according to Kenya's Ministry of Finance. This money, while constituting only a small fraction of Kenya's total external debt of around $5.6 billion, gives Chinese firms an outright lock in winning key road construction and other infrastructure-related contracts. The Chinese Econ/Commercial Counselor confirmed to Econ Counselor that all Chinese grants and concessional credits are channeled through China's Ministry of Commerce, and that all are conditional on the use of Chinese firms in carrying out the projects. For large infrastructure projects, he said, Chinese firms typically subcontract to local companies, and have long since abandoned the use of Chinese laborers for such projects because of cost considerations.

The Big Three: Roads, Power, and Telecom

¶10. (SBU) When looking at trade, aid, and investment holistically in the context of the overall bilateral economic relationship, China appears to have comparative advantages in areas which also happen to correspond to one of Kenya's greatest needs: namely infrastructure, and in particular, roads, power, and telecommunications. The PRC has help fund several road projects over the past several years, and it is no coincidence that the recent $14.7 million in PRC grants announced during the Kibaki visit to China are earmarked for roads in Nairobi, doubtless using Chinese engineering and construction firms. The $24 million concessional loan extended by Beijing during Kibaki's visit in turn is earmarked for upgrades in the power grid. The loan dovetails with private sector activities: North China Grid's local rep has been quoted in the international press as saying that his company's manufacture of concrete poles for power lines is just the beginning, and that the company has big plans to also supply power stations, substations, and power lines, alongside of which it hopes to lay fiber optic lines by winning government tenders.

¶11. (U) In the telecom arena, Kibaki is reported to have signed an agreement during his visit with Huawei Technologies of Shenzhen under which Huawei will supply a wireless communications system linking all district government offices across Kenya. Costs and financing details are unknown at this time. Kibaki also reportedly noted during his visit to Shenzhen that the GOK is negotiating with China's Eximbank for a KSh 1.8 billion ($24 million) soft loan to finance the upgrading of Kenya's rural phone network. Huawei has already supplied equipment and technical assistance to Kenya's monopoly fixed line provider, Telkom Kenya, as has Huawei's domestic Chinese rival, ZTE Corporation. In recent visits to meet with Telkom Kenya management, Econ Counselor has twice bumped into ZTE's local rep, a Shanghai native.

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Natural Resources: Scooping Up Titanium? Oil Too?
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¶12. (SBU) Much is made in the Western press of China's relentless pursuit of Africa's natural resources. Beyond its natural beauty and wildlife resources and the recent revelation that an Australian company will be drilling exploratory wells off the Kenyan coast, Kenya lacks significant natural resource deposits. But where there are any possibilities, Chinese interests are present. Earlier in 2005, Canadian mining giant Tiomin Resources was granted a license to strip mine for titanium in Kenya's Kwale District under terms which were not disclosed. The deal, which took eight years to negotiate, has been described in the press as one of the largest single foreign investments in Kenya. In the midst of Kibaki's visit to China, representatives from China's Jianchuan Group visited Kenya. Their visit, apparently hosted by Tiomin, included a visit to the office of Minister for the Environment and Natural Resources, where they were exhorted by the Minister to "take interest" in "the other minerals in this country". Press coverage reported that Jianchuan had signed an MOU with Tiomin declaring the former's intent to buy the titanium mined in Kwale. Again, terms and details are not transparent at this time, but China's Econ/Commercial Counselor told Econ Counselor in late August that Jianchuan is also prepared to make a "very large" investment in the Tiomin project if and when it is confirmed that the mine has commercially viable deposits.

¶13. (SBU) Private sector and government officials have also noted keen Chinese interest in development of oil pipelines from Southern Sudan (now that a peace agreement has been signed there) to the Kenyan Indian Ocean port of Mombasa. Chinese companies are said to be heavily involved in not only bids to build the necessary infrastructure but in buying the oil exported. Kibaki, during his visit to China, was quoted in the press as calling for Chinese assistance and participation in precisely this area.

Corruption: Does China Help or Hurt?

¶14. (SBU) The nature of corrupt business practices makes it difficult to say with any certainty that Chinese firms more readily pay bribes and engage in other corrupt activities as part of their normal business practices in Kenya. The rumor mill places a Chinese firm at the heart of the July 2004 last-minute cancellation of the award for a second landline phone license. As the story goes, when it became clear that the consortium which included both Chinese interests and relatives of President Kibaki would not win the tender, it intervened with Minister of Communications Raphael Tuju (who joined Kibaki on his trip to China) to have the tender cancelled. Tuju never sufficiently explained his actions, and probably exceeded his legal authority in intervening in the tender process. In April 2004, Chinese firm ZPMC won a controversial tender to supply eight gantry cranes worth $20 million to the port of Mombasa. The tender had twice been postponed by Cabinet ministers believed to have interests in companies competing in the tender. The good news, at least, is that ZPMC delivered the cranes as promised.

¶15. (SBU) Such allegations of corruption are difficult to prove, but without the equivalent of the Foreign Corrupt Practices Act, and in the context of pervasive corruption at all levels of Kenyan government and society, it seems inconceivable that Chinese firms don't contribute actively to the corruption problem in Kenya. Whether they do so more readily than companies from other countries is a matter of debate. On another level, however, the perception that Chinese firms and the Chinese government are willing to do business in Kenya without any strings attached is widespread, and this undermines in small ways efforts on the part of Western donors and domestic reformers to reduce corruption and improve governance. Government spokesman Alfred Mutua summed up the attitude of some in the GOK when he commented to the press recently: "The Chinese do not peg their economic activity or aid to political conditions...You never hear the Chinese saying that they will not finish a project because the government has not done enough to tackle corruption. If they are going to build a road, then it will be built."

China: Also a Scary Competitor

¶16. (SBU) Despite the generally positive media blitz surrounding the Kibaki visit to China, the growing economic relationship between the two countries is clearly a mixed blessing for Kenya, and many Kenyans know it. First, there is recognition on the part of some that China's willingness to play ball without concern for governance and corruption issues is in fact a problem, not an advantage. As one local columnist put it, China's "non-interference foreign policy does not encourage financial probity, political reform, and observance of human rights. Its only condition is support for the 'One China' principle."

¶17. (SBU) Of greater concern to the average Kenyan, and to the GOK, however, is China's competitiveness and what it means for Kenya's own industries. The bilateral trade deficit is symptomatic of this problem, and there is considerable acrimony within the Kenyan business community toward the growing presence of Chinese imports in Kenya, which many see as a direct threat to their viability, both in the domestic market and overseas. Even with duty paid, many Chinese goods, including textiles, garments, batteries, and electrical components, beat comparable Kenyan products on price.

¶18. (SBU) Nowhere do Kenyan fears of being overrun by more efficient Chinese companies in an increasingly globalized economy crystallize more clearly than in the garment industry. As noted ref B, Kenya's garment sector, which sprang to life over the past several years in large part due to preferences under the U.S. Africa Growth and Opportunity Act (AGOA), is now under threat from a combination of high costs at home, and greater Chinese competitiveness worldwide following the expiration of global apparel quotas under the Multi-Fiber Arrangement in January, 2005. Kenya's apparel workers are both more expensive than their Chinese counterparts, while also being less productive. As a result, as Chinese goods increasingly dominate markets in the U.S. and elsewhere, Kenya's hard-won AGOA gains are slipping away. As detailed in ref B, at least seven textile companies and over 11,000 jobs have been lost in the sector just since the beginning of 2005.

¶19. (SBU) Some Kenyan business leaders are publicly questioning China,s global trade posture and its impact on Kenya,s export opportunities. GOK officials echo these concerns, but to date, mostly in private. At a June 2005 meeting with members of the Common Market for Eastern and Southern Africa (COMESA), discussions centered primarily on figuring out ways of installing safeguard measures against China,s deluge of cheap exports to the continent. Kenyan

business interests as well as other COMESA members took aim at China for its alleged unfair trade practices. While there is also much discussion about the local impact of "substandard and counterfeit" goods coming in from China, the fact remains that even legitimate imports undercut local products on price in many instances. According to Elijah Manyara, Deputy Director for External Trade and the Ministry of Trade and Industry, Kenya has requested WTO anti-dumping consultations regarding Chinese exports of clothing and dry-cell batteries. A previous anti-dumping notification on dry-cells has expired, but, according to Manyara, Kenya is closely watching the situation and "keeping its options open."

Comment

¶20. (SBU) The Kibaki visit is seen by some observers as more than just an attempt to build a better economic relationship with a rising powerhouse in Asia. Some, including doubtless certain of Kenya's political leaders, see it in more strategic terms - as part of a policy to diversify Kenya's interests and build ties to Asia,s tiger economies, to distance Kenya from a pestering, imperialistic West (including the United States), and to play the West and China off of each other for Kenya's gain. We don't see Kenya's growing economic relationship in quite such Machiavellian terms, and do not believe we should take any such bait. In some respects (e.g., China's efforts to improve Kenya's infrastructure), our interests and those of Kenya and China clearly intersect. In other areas, they don't. China's assistance, given without reference to corruption concerns, for example, make it incrementally harder for Western donors to maintain pressure on the Kenyan leadership for improved governance. But at the end of the day, Kenya's economic and assistance ties to China, while growing rapidly, still remain peripheral compared to its much older, deeper, and broader ties to the region, to Europe, and to the U.S. These latter ties are also strong and growing, and we find it perfectly natural, indeed unavoidable, for Kenya to simultaneously reach out to China for help given the PRC's rising political and economic stature in the world.
BELLAMY